IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 660

MOLINE PROPERTIES, INC.,
Petitioner.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Ceritorari to the United States Circuit Court of Appeals for the Fifth Circuit.

PETITIONER'S BRIEF

BART A. RILEY,
Seybold Building,
Miami, Florida

THOMAS H. ANDERSON,
First National Bank Building,
Miami, Florida

H. H. EYLES,
Seybold Building,
Miami, Florida.

Attorneys for Petitioner.

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v.
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
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PETITIONER'S BRIEF

To the Honorable the Chief Justice and Associate Justices of the United States Supreme Court:

OPINIONS BELOW

The opinions of the Board of Tax Appeals is reported at 45 B. T. A. 647 (Rec. p. 19). The opinion of the Circuit Court of Appeals is reported at 131 Fed. (2d) 388, (Rec p. 89).

JURISDICTION

This case is here upon a writ of certiorari, which was granted March 8, 1943, to review the decision of the Circuit Court of Appeals for the Fifth Circuit, en-

tered on November 7, 1942, in an income tax case involving the taxable years of 1935 and 1936, in which the Board of Tax Appeals held that respondent had erred in determining deficiencies and penalties for 1935 and 1936, against petitioner. The Circuit Court of Appeals reversed the Board's decision. The jurisdiction of this Court is sustained by Section 240 of the Judicial Code, as amended (U. S. Code, Title 28, Section 347), and by Section 1141 of the Internal Revenue Code (U. S. Code, Title 26, Section 1141). The Circuit Court of Appeals had jurisdiction under the second of these sections, namely, Section 1141.

STATEMENT OF THE CASE

Respondent asserted deficiencies against petitioner for 1935 and 1936 in the amount of $4,993.92 of income taxes and $4344.95 of excess profits taxes, plus a delinquency penalty for 1936 of $788.35. The Board's decision setting aside respondent's determination (Rec. p. 22), was reversed by the court below (Rec. p. 89; 131 Fed. [2d] 388). The correctness of the decision below turns upon the question whether, as a matter of law, certain income from the sale of four lots of real estate in Miami Beach, Florida, was petitioner's income or that of its sole stockholder, Uly O. Thompson. That question in turn depends upon whether the petitioner (herein sometimes referred to as "Moline") was Thompson's agent, or stood in a fiduciary capacity to Thompson; or, stated differently, whether the Board's determination that Thompson was the beneficial owner of the lots and, therefore, that gain from their sale was not taxable to Moline, was erroneous as a matter of law.

Thompson, a Circuit Judge of a Florida state circuit court until comparatively recently, was also a large holder of other Miami Beach, and Miami real estate, title to all of which was in his name individually (Rec. p. 19; 52), except the four lots involved in this case. These,

which were acquired on August 17, 1920 (Rec. p. 17), were mortgaged by Thompson, in 1923, to one William F. Whitman for a debt of $20,000; and in 1936 they were subjected to a second mortgage given by Thompson to the Miami Beach Bank and Trust Co. (herein referred to as "Beach Bank") to secure an additional indebtedness of $20,000 (*ibid*) already existing, which was owing to that bank (Rec. p. 35). This land did not, however, prove profitable. In 1928 back taxes on the lots amounted to $6,500 (*ibid*). The second mortgagee insisted that these taxes be paid. At the time Thompson was very hard pressed for money. The president of the Bank of Bay Biscayne, Miami, (herein referred to as "Biscayne"), parent bank of the "Beach Bank," one Gilman (Rec. p. 36), called Thompson in and told him "he would have to do something about it (the taxes) or they would have to foreclose the mortgage," and that if he, Thompson, would let the bank organize a corporation, and transfer the property to the corporation, Biscayne would loan him sufficient money to pay the taxes (Rec. pp. 33, 36). Gillman was president of Biscayne, the parent Bank, and virtually controlled the Beach Bank, a subsidiary of Biscayne. Thompson was told, however, that the bank would not lend him the money unless he authorized the bank to form the corporation in which to place title to the property, and that when the corporation was formed he would have to hypothecate the stock to Biscayne to secure the tax money loan, and would have to give a voting trust to some bank officer to vote all of the stock at any time they saw fit (Rec. p. 36).

Thompson agreed (Rec. pp. 33, 36), and the bank had its attorneys organize the corporation (Rec. p. 33). The first minutes and corporate papers were brought to Thompson's office, and he signed them (Rec. p. 36). He testified, without contradiction, that that was the way the corporation Moline (the petitioner herein) was formed, and that "it was purely a receptacle to hold the title to this property in order to get the bank

to loan that money, to take care of the taxes." (Rec. p. 37) The stock was issued to Thompson, and it was turned over to Biscayne, and the voting trust was created in favor of that bank (Rec. p. 37). Moline assumed the two mortgages to Whitman and the Beach Bank (Rec. p. 37), but Thompson was never relieved of personal liability, and remained liable on both (Rec. p. 37). The reason for the assumption by the corporation, Moline, of these mortgages was explained as being the bank's insistence on the privilege of the right to apply all proceeds from the sale of the collateral to the liquidation of the two moragages (Rec. p. 38).

Biscayne closed in 1930 and its powers under the voting trust were thereafter exercised by the liquidator of the bank (Rec. p. 18). The general arrangement made in 1928, as already outlined, continued until 1933, when Thompson managed to raise the funds necessary to obtain a discharge of the obligations to the banks. Neither during this period, nor subsequently, did Moline ever keep any books of account or maintain a bank account at any time during its existence (Rec. p. 19). It never owned any assets except the four lots in question. It never had any office, place of business or employees, and except as herein stated it never transacted any business. It paid no salaries.

While the above arrangement was in effect, Thompson continued subject to Biscayne's dictation. Three matters referred to in the findings, belonging to this period, bear somewhat upon the question of the agency-fiduciary status of Moline which the Board found to exist, and incidentally illustrate Thompson's complete subserviency to the bank.

The first of these was a suit, brought in Moline's name, but at the bank's insistence and direction, to remove certain restrictions imposed by a prior deed on the land. Thompson was not even consulted about the matter (Rec. p. 41); but he did, before Moline was

formed, authorize bringing the suit (*ibid*). Expenses which included a fee of $5,000 which the bank agreed to pay the lawyers (*ibid*), Thompson knew would be charged against him (*ibid*). He made payments to that firm from time to time, beginning in 1933, and the bank also made some payments for his account (*ibid*). The Board included in its findings a recital that in 1933 he had personally paid $4,005.39 in this connection (Rec. p. 18). No part of these fees were paid by Moline, for it never had any funds.

The second of the transactions to which the findings refer is one of October 1, 1929, whereby Moline appeared to have purchased from Biscayne a note of Thompson's in the sum of $43000.00 on which interest of $9703.14 was due, in consideration of Moline's note for the purchase money, securing it with Thompson's mortgage (Rec. p. 18). This transaction, which was fraudulently procured at the instance, apparently, of questionable juggling of Biscayne's affairs by some of its bank officials (Rec. pp. 42 ff), was covered by minutes (Exhibit 1, Rec. p. 71; p. 42) prepared by the bank's personnel, which falsely recited Thompson's presence at the meeting, although he was not there in fact (Rec. p. 43). This or similar transactions appear to have caused the bank officials to be indicted (Rec. p. 44). It is not of great importance to the present case; but it illustrates the bank's control of the petitioner and Thompson's lack of independent volition.

The remaining matter referred to in the findings relates to certain condemnation proceedings during the same period, in which Moline, as record owner of the land, was a nominal party defendant. In connection with these proceedings Thompson, as President of Moline, was handed a check for $6500, which was sent over to the Beach Bank and may have been turned over to one of Thompson's creditors (Rec. p. 48). A reference to this matter appears in the false minutes already mentioned, but Thompson said he would not

want to be bound by that minute and did not know where the money went (Rec. p. 48).

All the encumbrances on these lots were liquidated on July 29, 1933, with funds obtained by a loan negotiated by Thompson with the National Investment Holdings, Inc., secured by a mortgage on part of the property in question (Rec. p. 18). Checks representing proceeds of this mortgage to National Holdings were made payable to Thompson (Rec. p. 40). This new debt was repaid in 1936 through the sale of property. After the debts due the bank were liquidated, the stock control of Moline was returned to Thompson.

After 1933 and until the sale of the lots, the only other matter bearing upon the present case was a lease, in 1934, of a part of the real estate for a parking lot, from which $1,000 was received (Rec. p. 19). Although it does not affirmatively appear from the record in whose account this rent money was deposited, it is, especially in view of the Board's general conclusion that Thompson was the beneficial owner, a fair inference from the fact that Moline had no account and from the entire testimony, that this relatively small sum was collected by Thompson personally.

In 1934, 1935 and 1936 the lots were sold in three separate parcels. The income sought to be taxed to Moline consists of the profit from the 1935 and 1936 sales. The proceeds were received by Thompson and deposited in his own bank account (Rec. pp. 19, 45).

Thompson, who knew nothing about income taxes and never made out a return in his life ,and whose salary as a state judicial officer during this period was not subjected to federal income taxation, employed an auditor to make out his returns (Rec. p. 45). The 1934 and 1935 sales were reported by the corporation, the present petitioner, in a corporation tax return, erroneously under the decision herein by the Board of

Tax Appeals. In 1936 Thompson's auditor learned of the Board's decision in the *Forshay* case, 20 B. T. A. 537 (Rec. p. 56), and suggested to Thompson that Moline was but a "dummy" corporation (*ibid*); and on his advice a refund claim was filed for 1935, and, on December 2, 1938, a delinquent personal return was filed in which Thompson reported the 1935 gain as his individual gain (Rec. p. 19). The 1936 sales were reported by Thompson personally, no return being filed by Moline for that year. The Commissioner assessed an additional tax for 1935 (on grounds not here material), assessed a deficiency for 1936 against Moline, and assessed against it the statutory delinquency penalty. Both these deficiencies, and the penalty, are bottomed on the formal separate entity of Moline, and the premise that the gain was not Thompson's but Moline's gain.

There is not the slightest suggestion that the corporation was formed for tax avoidance purposes, nor to protect Thompson against his personal liabilities. On the contrary, Thompson's personal obligation continued at all time, and, when Moline was organized, possible tax problems appear not to have been considered at all.

The Board of Tax Appeals, basing its decision squarely on the facts (Rec. p. 20), concluded that Thompson was the beneficial owner of the lots, and entered a decision of no deficiency (Rec. p. 21). The Circuit Court of Appeals reversed. It is the latter decision which is here for review.

SPECIFICATION OF ERRORS

The Court below erred in the following respects:

1. In holding that the employment of the corporate form was at Thompson's election.

2. In treating Thompson as estopped to assert that petitioner was a mere "dummy" corporation.

3. In failing to hold that on the facts petitioner was a mere agent, or fiduciary for Thompson, the beneficial owner.

4. In failing to uphold the Board's factual determination that Thompson was the beneficial owner of the lots.

5. In failing to uphold the Board's factual determination that the gain from the sale of the lots was not that of the petitoner, Moline.

6. In holding that as a matter of law the gains were taxable to Moline.

7. In reversing the decision of the Board of Tax Appeals in favor of petitioner.

ARGUMENT

QUESTION PRESENTED

The specific question for determination on the present record is whether as a matter of law the gain from the sale of real estate, title to which was in Moline's name, is taxable to Moline or to Moline's sole taxpayer and stockholder, Thompson, whom the Board found to be the beneficial owner of the real estate sold. Stated differently, and in the language of the petition herein (Petition, p. 6), the question is whether Moline, and Thompson, are estopped, as a matter of law, from asserting disregard of the corporate entity, and that Moline should be treated as a mere agency or instrumentality, and ignored for taxation purposes.

STATUTES INVOLVED

The statutes involved, set out, *infra*, in the appendix, are:

> Section 13(a), and 52 of the Revenue Act of 1934, ch. 277, 48 Stat. L. 680, and Sections 13(b), 22(a), and 52 of the Revenue Act of 1936, ch. 690, 49 Stat. L. 1648.

SUMMARY OF ARGUMENT

A corporation, although not *ipso facto*, an agent for its stockholders, may nevertheless be in fact such an agent; and where the facts evidence such agency, it should for tax purposes be treated as an agent, just as in any agency situation, even though its principal is a stockholder, or sole stockholder.

The Board of Tax Appeals has on numerous occasions, where the facts are like those of the present case, treated the corporation as "a mere figmentary agent" which should be "disregarded" for tax purposes. Whether in such cases (some of which are summarized in the argument) the corporate entity is to be considered as "disregarded," or the corporation's existence is to be "regarded" but the corporation recognized as being the agent which it is in fact, the result in such cases is sound, compels the taxation of income to him whose income it is, and precludes taxation of income to a party not beneficially the owner of it.

The opinion below summarily rejects the principle applied by the Board, that where a corporate agency for a stockholder is, on facts such as are here present, found to exist, income should be taxed to the beneficial owner. In so doing the court below misconceived the effect of this Court's decision in *Higgins v. Smith*, and followed the Eighth Circuit's erroneous application of that decision in the *Interstate Transit Lines* case.

In the present case the individual principally interested in the result is not, in order to avoid the tax consequences of his own chosen methods of business organization, disavowing that organization. What is claimed is that, in the absence of some other element of estoppel, an agency relationship shown by the present record to be actually existing be given effect for tax purposes, just as would be done in the case of corporate agency where the principal is not a sole or controlling stockholder.

The Board of Tax Appeals treated the facts proved in the present record as establishing an agency with respect to real estate beneficially owned by the sole stockholder. This factual conclusion not only was wrong as a matter of law, but was the only factual conclusion possible under the evidence, unless, as a matter of law, there is an estoppel against claiming that such evidence establishes the existence of the agency relationship. There is no such estoppel. Giving effect to the relationship accords with realities, and results in taxing the income to the party beneficially entitled to it.

The decision in *Higgins v. Smith* was one in which a tax payer was not permitted for tax purposes, to avail himself of his own corporate creature, which he himself created and used in other situations for tax avoidance. There was a jury verdict adverse to the taxpayer, not, as here, a favorable factual determination by the trier of the facts. The dicta relied on as overthrowing the line of authorities supporting the present petitioner's position merely declare that the tax disadvantages of the corporate form of conducting business cannot be disavowed by one who has deliberatly chosen that form. The dicta did not, however, make a change in the law of trusts or of agency, or preclude claiming that the corporate creature is in fact an agent if such is the fact.

The court below has in effect reversed the Board of Tax Appeals on a fact determination amply supported by the record, and has done so because it ignored or overrode, without challenging, finding of fact by the Board, and because of a misconception of the effect of the decision in *Higgins v. Smith*. Its decision should therefore be reversed, and the Board's decision reinstated.

I.

A CORPORATION EXISTING MERELY TO HOLD TITLE TO REAL ESTATE, WHICH IS IN FACT BUT A MERE AGENT OR FIDUCIARY FOR ITS STOCKHOLDER, WHO IS THE BENEFICIAL OWNER, SHOULD BE SO TREATED FOR TAX PURPOSES, AS IN THE CASE OF ANY AGENCY.

Until the recent decision of this Court in *Higgins v. Smith*, 308 U. S. 473, 60 S. Ct., 355, 84 L. Ed. 406, it had been frequently held that a corporation which, to borrow the Board's language in its opinion in the present case, exists merely to facilitate the passage of title to real estate, whose stockholders act without regard for its entity, is a "mere figmentary agent which should be disregarded in the assessment of taxes taxes." Perhaps it is not strictly accurate to refer to the result in such cases as one which "disregards" the entity. The separate entity is in a sense respected but recognized for what it is, a mere agent or fiduciary, and therefore the same tax consequences follow as in the case of any corporate agent or fiduciary, whether or not acting for the owners of its stock. Whether this a characterized as "disregarding" the entity or amounts merely to viewing the entity in its proper perspective, and giving it its true significance as a mere agent, is not important so far as the result is concerned. The latter concept, that the entity constitutes a mere agent, does no violence to the elementary rule of the separate fictional existence of the corporation. Language used in the decisions sometimes is to the effect that the separate entity may in some

circumstances be "disregarded," sometimes terms the subsidiary entity as an "agent," and sometimes suggests a confusion of both concepts.

A corporation is, of course, not *ipso facto*, the agent of its stockholders. It is a separate entity. But a corporation which is acting as agent for a stockholder, even a sole stockholder, is note the less an agent, even if its principel happens also to be its sockholder. While the fact of stock ownership, standing alone, does not create the relation of agency, yet the reverse is also true. The fact of stock ownership does not, *ipso facto*, negative the agency relationship.

Summary of some Board decisions in dummy corporation cases.

Some Board decisions, cited in its opinion in the present case, afford practical examples of "dummy" corporations that in fact were agents, and were so treated for tax purposes. These cases are recognized as not binding here, but are referred to as supporting the present petitioner's contention, and as illustrating a correct application of the law to similar factual situations.

In the present case the Board, saying (Rec. p. 21) that it had "frequently" regarded a corporation that is a mere holder of title as "a mere figmentary agent," "disregarding" the entity "to effect a more realistic assessment of taxes" (Rec. p. 21), cited five of its own prior decisions, one of which was the subject of an appeal which was upheld. These are:

Stewart Forshay, 20 B. T. A., 537.

J. A. McInerney, 29 B. T. A. 1. affirmed 82 Fed. (2d) 665.

Thrift Realty Co., 29 B. T. A. 545.

Mark A. Mayer, 36 B. T. A. 117.

Abram's Sons Realty Corporation, 40 B. T. A. 653.

The *Forshay* case, referred to in the record as the decision which occasioned Thompson's auditor to suggest that Moline was but a "dummy," was one in which persons interested in a corporation which owned an apartment building in New York City changed the form of the enterprise and created a new corporation to hold the property, which, instead of operating the enterprise as had the former corporation, would merely hold title for the benefit of "the persons in interest." Provision was made, in the instruments embodying the entire arrangement, that earnings would be distributed in fixed amounts annually, and for the distribution of the proceeds upon a sale of the property. These and other features of the arrangement (which was "voluntary" in the real sense, not as here an arrangement imposed by a creditor upon a debtor) were regarded by the Board of Tax Appeals as making it evident that the corporation did not take title on its own behalf or for its own benefit, but for that of the parties in interest. After referring to and quoting from certain New York statutes on the subject of Trusts, and saying that it made no difference whether a passive trust, a power in trust, or a mere agency was created, the Board concluded that in either case no estate or interest vested in the corporation, but the parties in interest took both legal and equitable title. Any income therefrom was that of the latter, not of the corporation.

In the *McInerney* case, the Board and Circuit Court of Appeals for the Sixth Circuit treated a similar corporate entity, which was, on the facts, a mere conduit for passing title, as of no effect to enable the taxpayer to avoid the consequences that payment by the purchaser for property thus transmitted was constructively received by the stockholder.

In the *Thrift Realty Co.* case, the Board on considerably stronger facts in favor of the taxing officers than those of the present case treated a similar corporation as a mere trustee for stockholders at the time certain real estate standing in its name was sold, and said in this connection that the fact that the taxpayer was a corporation in which the individuals affected owned all the stock "does not affect the status of agency."

In the *Mayer* case the Board delt with the question whether the net loss of a partnership should include income and deductions of a corporation whose stock was all owned by the partnership. The latter owned considerable real estate which it used in its regular business. Long before the income tax laws were passed it had organized a corporation for the sole purpose of holding title to the real estate which was transferred to the corporation. Title to real estate thereafter acquired was taken in the corporation's name. Otherwise the corporation transacted no business. It kept no books, and never had an office, employees, agents or a bank account. Receipts were collected by the partnership and expenses were paid by it, and it dealt with the lands as if it, not the corporation, held legal title. The purpose of organizing the corporation and continuing its existence was for convenience in handling property, including conveying title, and avoidance of title complications in case of a partner's death. The Board, after recting that ordinarily corporations have a separate existence apart from their stockholders, yet recognized that it, and the courts, had looked through the form and regarded substance "where the facts were peculiar," for which proposition there were cited, among other cases, this Court's decision in *Southern Pacific v. Lowe,* 247 U. S. 330, 38 S. Ct. 340, 62 L. Ed. 1142, and *Gulf Oil Corporation v. Lewellyn,* 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133. Upon a consideration of the facts the Board concluded that the partnership, not the corporation,

was the beneficial owner of the land, and that therefore receipts and disbursements were the partnership's, not the corporation's.

The *Abram's Sons* case resembled the present one in that the corporation was organized at the demand of creditors, to hold record title to certain real estate, and to receive, for creditor interests, the proceeds of a condemnation proceeding. Unlike the present case, the equity owners realized nothing after application of the proceeds. The Board treated the corporation as a mere trustee or agent to dispose of the property and act as a conduit and distribute the proceeds for creditors. Under these circumstances and on the authority of the *Forshay* case and other Board cases, the gain was held not taxable to the corporation.

The above cases were, it is submitted, correctly decided, and their reasoning and logic were correctly applied by the Board in the present proceeding (Rec. p. 11). To borrow the Board's reasoning in another Board decision, *Carling Holding Corp.*, 41 B. T. A. 493, if the contest were between the corporation (in this case, Moline, the petitioner herein) and those for whom it was acting, instead of a tax case, neither the corporation, nor the voting trustee, nor the Biscayne, could have contended that any profit belonged, as against Thompson, to Moline; for, in the Board's language, so to hold "would be a travesty upon the law of agency or trusteeship." 41 B. T. A. 493, at p. 503.

There are other decisions to the same effect, some of which are cited in the Board's opinions in the cases just mentioned. These cases properly insisted that income should be taxed to the party who or which is beneficially interested in such income, not to a mere formal holder of the title to property from which the income is derived, or to a mere agent or fiduciary not in fact beneficially interested. Such appears to have

been the generally accepted rule in cases of this kind.

The opinion below appears to be the first case involving such a fact situation in which a corporation holder of formal title to real estate which is a mere shell, or "figmentary agent," has been held taxable on income or gain from property where the beneficial interest is in the stockholder.

II.

THE OPINION BELOW IN EFFECT HOLDS, CONTRARY TO THE MANY DECISIONS IN SIMILAR CASES, THAN AN ESTOPPEL EXISTS AGAINST ASSERTING, IN A TAXPAYER'S FAVOR, THAT A CORPORATION IS IN FACT BUT AN AGENT FOR ITS STOCKHOLDERS. THIS HOLDING IS UNWARRANTED, ESPECIALLY IN THE FACE OF THE BOARD'S CONCLUSION THAT THE BENEFICIAL INTEREST WAS IN THE STOCKHOLDER.

The opinion below, ignoring or misconceiving the testimony, treats this subject summarily, on the supposed authority of *Higgins v. Smith*, and of the *Interstate Transit Lines* decision by the Eighth Circuit, now on review in this court.

The opinion of the court below is an example of the extreme in oversimplification. After reciting the facts, the bare assertion is made that the Board "erred in its decision." The general rule is cited that a corporation and its stockholders are for purposes of taxation different entities; and then the Board's findings and conclusions of fact, (abundantly supported by the record, which could permit of no other findings or conclusions of fact), and its opinion, were disposed of in five short sentences (Rec. p. 91; 131 Fed (2d) 388 at p. 389). It is declared that Thompson "for reasons satisfactory to himself and his creditors elected to employ a corporation" (thus ignoring the complete lack of any real volition or freedom on Thompson's part, and, in spite of the abundant evidence to the contrary, treating Thompson as having a free choice in the mat-

ter, when his only choice was surrender to the creditor's demand or loss of his property); and then, upon the postulate that Thompson had "chosen the corporate form to conduct these affairs," the opinion says that both he and the corporation "must accept the tax disadvantages," and "may not now, in order to escape corporate taxes, be heard to disavow the corporate existence and allege that the respondent (in the court below, petitioner here) was merely a "dummy corporation."

Not a word is said concerning the legal consequences of the Board's conclusion that it was Thompson who had beneficial ownership. Thus is it in effect declared that an estoppel existed against proving that the corporation was in fact but an agent, although in any other situation where the relationship of agency exists there would be no doubt that gain would be taxed to the beneficially interested party, not to the agent.

For this remarkable and, we submit, clearly erroneous pronouncement, at least as applied to the facts proved of record and found by the Board, the court below cited two authorities, this Court's decision in *Higgins v. Smith*, 308 U. S. 473, 60 S. Ct. 355, 84 L. Ed. 406, and the Eighth Circuit's decision in *Interstate Transit Lines v. Commissioner*, 130 Fed. (2d) 136. The *Interstate Transit Lines* opinion and the opinion below both overlook the significance of the fact of agency.

The *Interstate Transit Lines* opinion, after referring to *Southern Pacific v. Lowe*, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142, and *Gulf Oil Corporation v. Lewellyn*, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133, and some Circuit Court of Appeals decisions cited by the taxpayer in that case in support of the "agency" contention, says (130 Fed. [2d] 136 at p. 140) that these cases "cannot be regarded as laying down any general rule authorizing disregard of corporate entity in respect of

taxation," for which assertion *Burnet v. Commonwealth Improvement Corp.*, 287 U. S. 415, 53 S. Ct. 198, 77 L. Ed. 399, is cited. The Eighth Circuit opinion then cites *Higgins v. Smith*, from which is quoted the dictum that "a taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the disadvantages," but that the Government "may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute."

The quoted language, for which presumably the Court below in the present case cited the *Interstate Transit Lines* case, loses sight of the fact that the taxpayer in a proper case of this kind is not contending that he should be relieved of the consequences of his own chosen method of doing business. He is asking that the fact of the agency relationship be recognized and that the usual consequences of that relationship be given effect. This oversight may be a result of some of the loose language that has appeared in the books to the general effect that in certain situations "the corporate entity will be disregarded." Whether or not the "dummy corporation's" fictional entity be "disregarded," the same result should follow that would follow in the case of an actual agency where the principal is not the agent's stockholder. Unless there be some other element of estoppel present, ownership of corporate stock does not estop the owner from establishing an agency relationship, if such in fact exists. Authorities where the "agency" doctrine has been applied have treated facts like those here presented as evidencing agency.

Because the brief in the *Interstate Transit Lines* case now pending in this Court (Docket No. 552) discuss the holdings of this Court in *Southern Pacific Co. v. Lowe*, 242 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142, and *Gulf Oil Corporation v. Lewellyn*, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133, and also *Burnet v. Common-*

wealth Improvement Corp., 287 U. S. 415, 53 S. Ct. 198, 77 L. Ed. 399 (which is plainly distinguishable), the present petitioner will omit discussion of these autthorities. The discussion of them in the petitioner's brief in the *Interstate Transit Lines* case (No. 552 on this Court's docket) is adopted in this petitioner's behalf.

The Board of Tax Appeals' factual determination in the present case has ample evidence to support it, and the Board properly concluded that the gain was not Moline's but was Thompson's.

The Board of Tax Appeals treated the facts proved in this case as establishing the "agency" of Moline in respect of property beneficially owned by Thompson. It is submitted that the Board's factual conclusions were the only ones possible under the uncontradicted testimony in the present record, and that a contrary conclusion would have constituted an error of law, and would have been without any evidence to support it; but however that may be, the Board did find that Thompson, not the corporation taxpayer, the present petitioner, was the beneficial owner. The Court below, rejecting this conclusion, or at any rate ignoring it, has either: decided that as a matter of law it can never be concluded that such facts as here exist establish a corporation's agency for its sole stockholder, so that in effect there is an estoppel against claiming the benefit of the true relationship; or, has, in spite of this Court's many pronouncements on the subject, disturbed, without direct challenge of the correctness thereof, a factual determination of the Board, abundantly supported by the evidence, and has done so under the guise of a holding that the Board has erred in applying the law.

Thompson owned other extensive real property in Miami (19), from which circumstance it may be inferred that he was engaged generally in the business

of dealing in real estate. He did not, however, employ the corporate form in the handling of this business. Had he in effect operated the business of dealing in real estate through the medium of a corporation actually and actively conducting the business, then the ownership of all the stock would not, without more, have made has corporation's gain his gain. As applied to situation like that, it may be correct to say that a taxpayer thus conducting his affairs must accept the tax disadvantages. That is not the present case. Thompson, at a creditor's insistence and demand, acquiesced in the use of a corporation to hold title to some of his real estate. The instigator of the organization of the corporation was the bank, not Thompson. It was the bank's, not his, purpose that was served, aside from the fact that he thereby avoided the harsh alternative of loss of the property. After he regained control, in 1933, he did not, it is true, immediately dissolve the corporation or transfer record title back to himself but he dealt with the property as his own. He had no purpose of tax avoidance. (Indeed, the contrary is the case, as the present proceeding demonstrates.) His and the corporation's non-action with respect to the record title did not change the fiduciary relationship which the Board determined to have existed, under which Moline, the record owner, merely held title for Thompson, the beneficial owner. If he was the beneficial owner then it follows that Moline was a fiduciary. Whether Moline be termed "fiduciary" or "agent" is not important. What is important is that the property, and therefore the gain from its sale, was not Moline's, any more than in the case of a sale by any agent or fiduciary of his principal's or his beneficiary's property.

III.

THE DECISION OF THIS COURT IN HIGGINS V. SMITH HAS NOT CHANGED THE LAW CONCERNING THE AGENCY DOCTRINE, AND, INSTEAD OF REQUIRING REJECTION OF THAT DOCTRINE WHEN INVOKED IN A CASE LIKE THE PRESENT, SUPPORTS THE OPPOSITE RESULT.

The Court below, and the Eighth Circuit Court of Appeals[1] in the *Interstate Transit Line* case, have treated this Court's well known decision in *Higgins v. Smith*, 308 U. S. 473, 60 S. Ct. 355, 84 L. Ed. 406, as in effect holding that the Government, in a tax case, may at will "disregard" the corporate entity, while the taxpayer may under no circumstances assert the existence of an agency relationship. If these courts are right in thus construing *Higgins v. Smith*, the one sided situation thus resulting respresents a somewhat startling change in what has heretofore been generally assumed to be the law applicable to these cases.

In that case Smith sued Higgins, the Collector of Internal Revenue, for a refund of taxes. The question was whether the taxpayer was entitled to deduct a loss arising from the purported sale of securities by him to his wholly owned corporation. Officers and Directors of the corporation were Smith's subordinates. Its transactions were carried on under his direction and were largely restricted to operations in buying securities from or selling them to the taxpayer. This Court, in the opinion, termed the corporation Smith's "corporate self." It was created to gain income and estate tax savings for Smith, and thus was an attempted tax avoidance device. Under these circumstances this Court held that the Second Circuit Court of Appeals had erred in

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1. That court's recent decision in *Palcar Real Estate Co. v. Commissioner*, 131 Fed. (2d) 210, is clearly distinguishable on the facts from the present case, and contains language apparently recognizing the difference between an active corporation and "a mere passive holder of the title." The case does, however, regard the language of *Higgins v. Smith* as did the court below.

reversing and remanding a District Court judgment, rendered pursuant to a jury verdict, in favor of the Collector. The trial court gave an instruction, which this Court approved, that the jury were to find whether the sales by Smith to the corporation, out of which grew the asserted loss, were actual transfers of property out of Smith into something that existed separate and apart from him, or to be regarded as simply a transfer by Smith's left hand "being his individual hand, into his right hand, being his corporate hand, so that in truth and fact there was no transfer at all." The jury took the latter view and brought in a verdict for the Collector. This Court not only said there was sufficient evidence to sustain the verdict. The opinion goes further and adds that "this domination and control is so obvious in a wholly owned corporation as to require a peremptory instruction that no loss in the statutory sense could occur upon a sale by a taxpayer to such an entity."

It was said that "there is not enough of substance in such a sale finally to determine a loss." Stated in another way, it may be said that after the transaction in question Smith was neither richer nor pooer than he had been before.

The opinion refers to what is termed "the natural conclusion that transactions, which do not vary, control or change the flow of economic benefits, are to be dismissed from consideration." That in effect states one contention of the present petitioner; for, in the succeeding language of the opinion, "the purpose here is to tax earnings and profits less expenses and losses," but "if one or the other factor in any calculation is unreal, it distorts the liability of the particular taxpayer to the *detriment or advantage* of the entire tax-paying group. (Italic ours.) If an "unreal" factor can work to the "advantage of the entire tax-paying group" it is because the particular taxpayer is overtaxed as a result of the "unreal" factor. That is the situation here.

It is "unreal" to treat Moline as the owner of the lots. If a taxpayer is not permitted to show the fact of such "unreality," then the word "advantage" in the *Higgins v. Smith* opinion is meaningless. The reference to "detriment or advantage" negatives the view that a one-sided rule was being announced.

The opinion then refers to *Burnet v. Commonwealth Improvement Co.*, 287 U. S., 415, 53 S. Ct. 198, 77 L. Ed. 399, which had been cited by Smith in support of his contention. That case involved the converse situation; but in that case there was also an element of tax avoidance. The principal stockholder there had used the corporation to reduce taxes, and later, when it was to his advantage in order to avoid subjection of the corporation to a tax on a sale of corporate stock by the corporation to the stockholder, the claim was made that the corporation and stockholder were one. This Court in that case required observance of the corporate entity created originally to reduce taxes, but expressly recognized that the entity might be disregarded in a taxpayer's favor under "peculiar circumstances." That case did not present any question of agency, and the interested parties had in the past obtained substantial tax benefits from the corporation's existence.

It was in the course of commenting on the *Commonwealth Improvement Co.* case, and with direct reference to that case, and by way of distinguishing that case, that this Court then gave utterance to the dicta now relied on in order to base taxes on what are in fact unrealities. When the dicta are quoted for this purpose certain phrases are usually taken apart from their context, and given improper emphasis that disappear when the entire text is read. The full quotation is:

> "In the *Commonwealth Improvement Co.*, case, the tax payer, for reasons satisfactory to itself, *voluntarily* had chosen to employ the corporation in its operation. A taxpayer is free to

> adopt such organization for his affairs as he may choose and having elected to do so some business as a corporation, he must accept the tax disadvantages. (Italics ours.)
>
> "On the other hand, the government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute. To hold otherwise would permit the schemes of taxpeyers to supercede legislation in the determination of the time and manner of taxation. It is command of the income and its benefits which marks the real owner of the property."

It is, therefore, seen that this language, viewed in the setting which was the occasion of it, is directed against "schemes" of tax avoidance of which the *Commonwealth Improvement Co.* case was an example, *and with direct reference to that very case,* and is not a sweeping generalization for application in all cases, including those of agency. No mention is made of agency situations. The quoted language is used to support the conclusion, in a case in which there had been a determination by the triers of fact that a transaction was a sham, that the government is not bound by that sham. In other words the taxpayer went through certain motions, but, as in *Gregory v. Helvering,* 293 U. S., 465, 55 S. Ct. 266; 79, L. Ed. 596, 97 A. L. R. 1355, which is also cited, he did not actually do what he attempted to do.* On the other hand, where, as in the *Commonwealth Improvement Co.* case, the taxpayer employs the coroprate device and there is no agency situation, and especially where he thereby reduces taxes, he may not be heard later to disavow his own creature, voluntarily

created. (Moline was forced upon Thompson) when it is to his advantage so to do.

To give the quoted language in *Higgins v. Smith* the effect claimed for it would nuuify the preceding language in the same opinion, which recognizes that "unreality" (as distinguished from sham) may work either way. The case of *Higgins v. Smith* not only does not support the opinion of the court below; it lends strong support to the petitioner, and to the Board's decision.

The Fourth Circuit Court of Appeals in *U. S. v. Brager Building and Land Corporation*, 124 Fed. (2d) 349, quotes in full the above language from *Higgins v. Smith*, and then points out, in response to the Commissioner's argument, that "the diversity of business transactions in corporate form does not permit of so easy a generality" as that asserted by the Commissioner. The language in the Brager opinion, criticizing the "easy generality" of government's contention is equally applicable to the oversimplification indulged in by the Court below.

The Brager opinion recognizes that "schemes" to escape taxation will not be tolerated; but continues by saying that "it is going too far to say that if a taxpayer forms a corporation for his convenience, he is thereafter estopped from disclosing the true nature of the arrangement, whenever it is of advantage to the government to recognize only the corporate form." Reference in succeeding sentences to cases dealing with the situation "when a corporation has been formed merely as an agency to hold title to real estate for the convenience of the owner" makes it clear that what is meant is that if "the true nature of the arrangement" is an agency, the usual result must follow. It is submitted that the Brager opinion correctly construed the language and holding in *Higgins v. Smith* and that to quote again from the Brager opinion, the "body of the

law" relating to agency situations of the present sort cannot be regarded as having "now for practical purposes ceased to exist."

As the Brager opinion points out, the opinion in *Higgins v. Smith* does not preclude assertion, in such cases, of the fact of the agency relationship. The latter opinion is a warning against "schemes" of taxpayers to avoid, through corporate devices, taxes they really owe if economic realities are given effect. While it is true that a taxpayer's intent lawfully to minimize his taxes does not render unlawful what is otherwise lawful, yet a taxpayer who attempts a transparent "scheme" or device of the kind under scrutiny in *Higgins v. Smith* risks one of two consequences: if, as was the case in *Higgins v. Smith*, the device is a sham, the Government may, notwithstanding the sham, apply the philosophy of *Gregory v. Helvering, supra*, p. 25, and disregard it altogether. If, however, as in the *Commonwealth Improvement Co.* case, the taxpayer's "scheme" to reduce taxes produces, if given effect, a tax disadvantage, the Government may compel him to accept these consequences of his "scheme."

No such situation of attempted tax reduction is present here. The opinion in *Higgins v. Smith* does much more than condemn attempts of taxpayers to retain the fruits of income but escape the tax on such income. It also condemns determination of tax liability on the basis of "unrealities." This portion of the opinion the court below appears to have overlooked. When *Higgins v. Smith* is cited in support of the one-sided rule contended for by respondent and apparently announced by the court below, and by the Eight Circuit in the *Interstate Transit Lines* case, no mention is made of this condemnation of the use of an "unreal" factor in calculating taxes. In the present case, Moline's record ownership of the land is a necessary "factor" in the "calculation" of the deficiencies here under review. Such ownership is "unreal"; it is just as "unreal" as

the legal title held in trust for another, so far as the question of beneficial interest is concerned; such record ownership was merely as another's, Thompson's agent, or, if one prefers the term, trustee; and the Board so found. The court, however, reversing the Board, has exalted the "unreal" thing, the formal title in Moline, to become a "factor" in the "calculation" of a ruinous tax, which, because he is obviously a "transferee," Thompson, in spite of his financial troubles which the record so clearly portrays, will be forced to meet somehow. This, if the court below is upheld, is the only "reality" about the result, a harsh reality which, if allowed to stand, will represent a miscarriage of justice, and a discrimination against Thompson. The obvious effect would in such case be that Thompson pays more than the tax on his gain, for he would pay at the corporate instead of the individual tax rate, and in addition be mulcted in interest and penalties. Such an unfair discrimination is not warranted by anything in this record. It is condemned by the language and reasoning of *Higgins v. Smith*. It is contrary both to common sense and to the clearest dictates of justice. The gain on the sale of these lots should, petitioner submits, be taxed to Thompson, the real owner, not to Moline, the mere title holder, or "agent."

CONCLUSION

For the foregoing reasons it is earnestly submitted that the Court below has erred in holding that this Court's decision in *Higgins v. Smith* required as a matter of law the taxation to Moline of the gains from the sale of the lots here involved, and in reversing the Board of Tax Appeals, and accordingly it is urged that the decision of the Circuit Court of Appeals of the Fifth Circuit be reversed and that of the Board of Tax Appeals affirmed.

Respectfully submitted.

BART A. RILEY,

THOMAS H. ANDERSON, ...

H. H. EYLES, ...

Attorneys for Petitioner. Attorneys for Petitioner.

APPENDIX

Revenue Act of 1934, ch. 277, 48 Stat. 680:

SEC. 13. TAX ON CORPORATIONS.

(a) Rate of Tax. There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, * * *

SEC. 22. GROSS INCOME.

(a) General Definition. "Gross income" includes gains, profits and income derived from * * * sales, * * *

SECTION 52. CORPORATION RETURNS.

Every corporation subject to taxation under this title shall make a return, * * *

Revenue Act of 1936, ch. 690, 49 Stat. 1648:

SEC. 13. NORMAL TAX ON CORPORATIONS.

* * *

(b) Imposition of Tax. Tsere shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation, a normal tax as follows:

* * *

The provisions of Sections 22 (a) and 52 of the Revenue Act of 1936, supra, are identical with those set forth above.